banking info
INFO PERBANKAN



Your guide on

Basic Concepts and **Principles** of **Islamic Banking**

Contents

This booklet tells you about the basic concepts and principles of Islamic banking.

What is Islamic banking?

Islamic banking is banking based on Islamic law *(Shariah)*. It follows the *Shariah,* called *fiqh muamalat* (Islamic rules on transactions). The rules and practices of *fiqh muamalat* came from the *Quran* and the *Sunnah,* and other secondary sources of Islamic law such as opinions collectively agreed among *Shariah* scholars *(ijma'),* analogy *(qiyas)* and personal reasoning *(ijtihad).*

Islamic banking in Malaysia

- The first Islamic bank was established in Malaysia in 1983.
- In 1993, commercial banks, merchant banks and finance companies begun to offer Islamic banking products and services under the Islamic Banking Scheme (IBS banks).
- The IBS banks have to separate the funds and activities of the Islamic banking transactions from the non-Islamic banking business (conventional banking).
- You can identify an Islamic bank or an IBS bank from the logo below:

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Observing *Shariah* principles

All Islamic banks and IBS banks have set up *Shariah* Committees to guide them on *Shariah* matters and to make sure that they function in a manner that is in line with the *Shariah.* In addition, the advice of the *Shariah* Advisory Council which is the highest *Shariah* body set up at Bank Negara Malaysia, can be sought to ensure uniformity in views and practices. The members of the *Shariah* Committees and the *Shariah* Advisory Council are academicians and *Shariah* experts in Islamic banking and finance.

Shariah concepts in Islamic banking

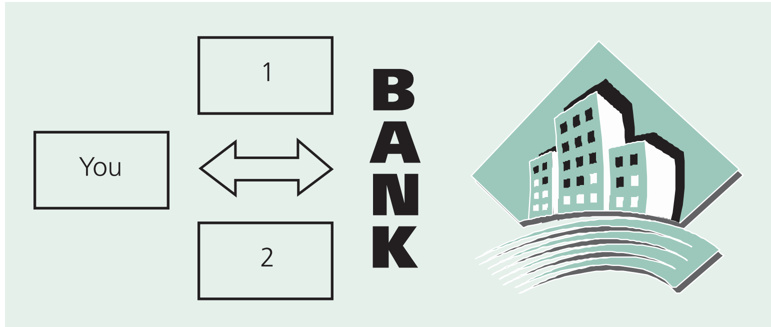
The common *Shariah* concepts are as follows:

Wadiah **(Safekeeping)**

Wadiah means custody or safekeeping. In a *Wadiah* arrangement, you will deposit cash or other assets in a bank for safekeeping. The bank guarantees the safety of the items kept by it.

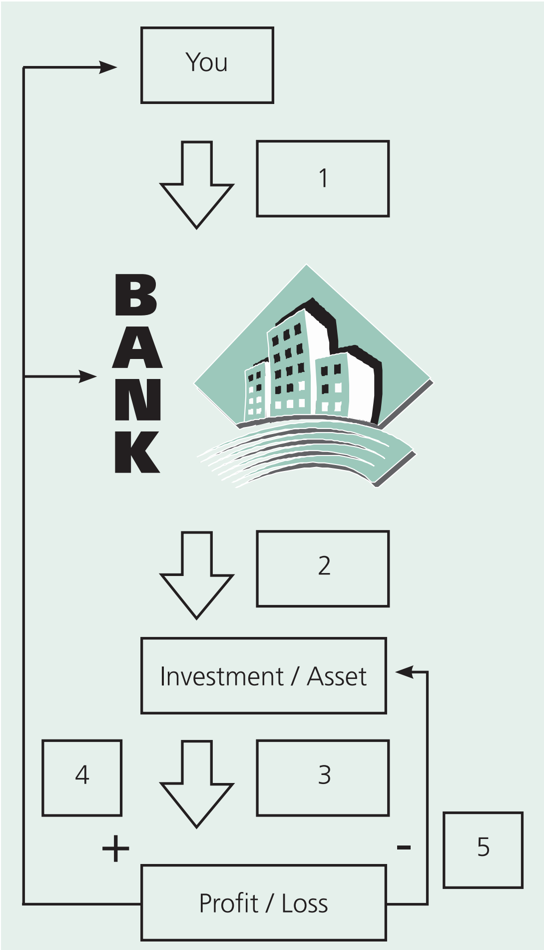
Know the *Shariah* concept used and be clear of your rights and responsibilities

Here is how it works:



1) You place money in a bank and the bank guarantees to return the money to you.
2) You are allowed to withdraw the money anytime.
3) Bank may charge you a fee for looking after your money and may pay *hibah* (gift) to you if it deems fit.
4) This concept is normally used in deposit-taking activities, custodial services and safe deposit boxes.

Here is how it works:



Mudharabah (Profit sharing)

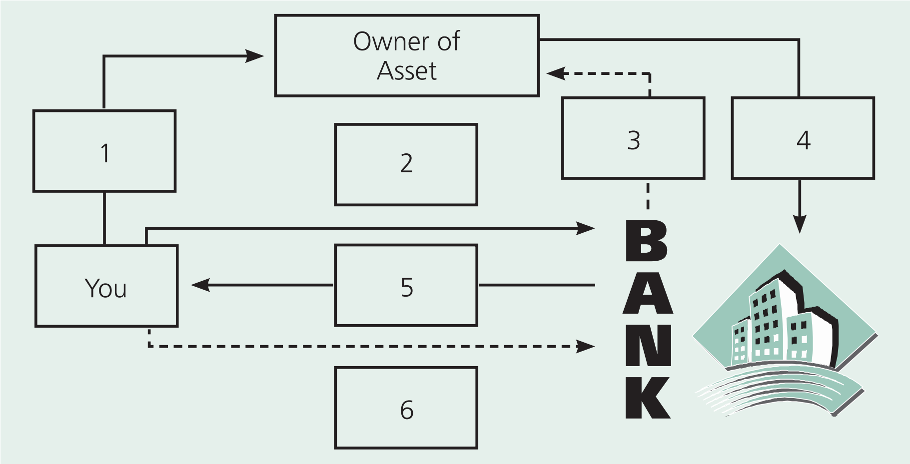
Mudharabah is a profit sharing arrangement between two parties, that is, an investor and the entrepreneur. The investor will supply the entrepreneur with funds for his business venture and gets a return on the funds he puts into the business based on a profit sharing ratio that has been agreed earlier. The principle of *Mudharabah* can be applied to Islamic banking operations in 2 ways: between a bank (as the entrepreneur) and the capital provider, and between a bank (as capital provider) and the entrepreneur. Losses suffered shall be borne by the capital provider.

1) You supply funds to the bank after agreeing on the terms of the *Mudharabah* arrangement.
2) Bank invests funds in assets or in projects.
3) Business may make profit or incur loss.
4) Profit is shared between you and your bank based on a pre-agreed ratio.
5) Any loss will be borne by you. This will reduce the value of the assets/ investments and hence, the amount of funds you have supplied to the bank.

Bai' Bithaman Ajil – BBA (Deferred payment sale)

This refers to the sale of goods where the buyer pays the seller after the sale together with an agreed profit margin, either in one lump sum or by instalment.

Here is how it works:



1) You pick an asset you would like to buy.
2) You then ask the bank for BBA and promise to buy the asset from the bank through a resale at a mark-up price.
3) Bank buys the asset from the owner on cash basis.
4) Ownership of the goods passes to the bank.
5) Bank sells the goods, passes ownership to you at the mark-up price.
6) You pay the bank the mark-up price in instalments over a period of time.

Murabahah (Cost plus)

As in BBA, a *Murabahah* transaction involves the sale of goods at a price which includes a profit margin agreed by both parties. However, in *Murabahah,* the seller must let the buyer know the actual cost for the asset and the profit margin at the time of the sale agreement.

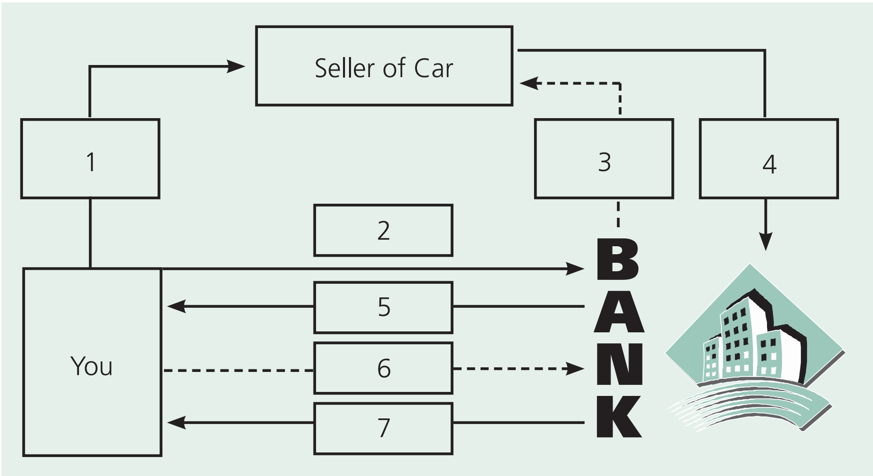
Musyarakah (Joint venture)

In the context of business and trade, *Musyarakah* refers to a partnership or a joint business venture to make profit. Profits made will be shared by the partners based on an agreed ratio which may not be in the same proportion as the amount of investment made by the partners. However, losses incurred will be shared based on the ratio of funds invested by each partner.

Ijarah Thumma Bai' (Hire purchase)

Ijarah Thumma Bai' is normally used in financing consumer goods especially motor vehicles. There are two separate contracts involved: *Ijarah* contract (leasing/renting) and *Bai'* contract (purchase). The contracts are made one after the other as shown in the diagram on page 7.

Here is how it works:



1) You pick a car you would like to have.
2) You ask the bank for *Ijarah* of the car, pay the deposit for the car and promise to lease the car from the bank after the bank has bought the car.
3) Bank pays the seller for the car.
4) Seller passes ownership of the car to the bank.
5) Bank leases the car to you.
6) You pay *Ijarah* rentals over a period.
7) At end of the leasing period, the bank sells the car to you at the agreed sale price.

Wakalah (Agency)

This is a contract whereby a person (principal) asks another party to act on his behalf (as his agent) for a specific task. The person who takes on the task is an agent who will be paid a fee for his services.

> **Example**
> A customer asks a bank to pay someone under certain terms. The bank is therefore the agent for carrying out the financial transaction and the bank will be paid a fee for its services.

Qard (Interest-free loan)

Under this arrangement, a loan is given for a fixed period on a goodwill basis and the borrower is only required to repay the amount borrowed. However, the borrower may, if he so wishes, pay an extra amount (without promising it) as a way to thank the lender.

> **Example**
> A lender who lent RM5,000 to a borrower on *Qard* will expect the borrower to return exactly RM5,000 to him at a later date.

Hibah (Gift)

This refers to a payment made willingly in return for a benefit received.

Example

In savings operated under *Wadiah,* banks will normally pay their *Wadiah* depositors *hibah* although the accountholders only intend to put their savings in the banks for safekeeping.

Always get further explanation from your bank on any doubts



Frequently asked questions

Q: Is Islamic banking meant for Muslims only?

A: No. Islamic banking is for all individuals regardless of their religious beliefs.

Q: What are the differences between Islamic and conventional banking?

A: The most important difference between Islamic and conventional banking is that Islamic banking must follow the *Shariah.* Islamic banking must also avoid activities such as *riba'* or *gharar* (excessive uncertainty). For example, instead of charging interest on financing given out, Islamic banks give financing based on *musyarakah* and will share any profit and loss.

Q: How do Islamic banks and IBS banks reward their depositors since payment of interest is not allowed?

A: In *Shariah,* there are many ways to share profit or returns between a bank and its customers. For example, in a deposit product, profits from a deposit arrangement will be shared between a bank and its depositors based on an agreed ratio and paid as dividends. *Shariah* also allows a bank to give *hibah* (gift) to its depositors as it deems fit.

Q: Where can I get Islamic banking products and services?

A: Islamic banking products and services are offered at any bank that carries the Islamic banking logo shown below.

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For the latest update on the list of banks that offers Islamic banking products and services, please visit Bank Negara Malaysia's website at www.bnm.gov.my.

Q: Where can I make a complaint if I am not satisfied with the services provided by an Islamic bank or an IBS bank?

A: You should contact your bank if you have any complaints. All Islamic banks and IBS banks have set up a Complaint Unit to deal with customers' complaints. You can get the information on the contact person, telephone number and email address of a bank's Complaint Unit from Bank Negara Malaysia's website at www.bnm.gov.my.

For more information on how to make a complaint, please read the booklet on "Making a Complaint".

Glossary

Gharar - An unknown fact or condition. An element which must be avoided in Islamic banking dealings as excessive *gharar* may make the contract null and void.

Riba' - The amount paid or received over and above the principal in a loan contract.

Shariah - The Islamic law which came from various sources – the *Quran*, the *Hadith*, the *Sunnah*, *ijma'* (views collectively agreed by Muslim scholars), *qiyas* (analogy) and *ijtihad* (personal reasoning) of the Muslim jurists.



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